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Does The Bull Still Have Legs?

Since the bottom of the Great Recession in March of 2009, the Standard and Poor's 500 Index is up 162%. With economic recovery globally remaining lackluster, central banks have been flooding the world in money and have co-operated to keep interest rates at ultra-low levels for years. With vanishing inflation (for the time being), government bonds have been unattractive for some time. The rotation from bonds to equities has begun. Equities have become the only game in town. US equities in particular have led the run, up about 24% in 2013 alone (most fixed income indices are down).

So, what to do with investment dollars today?

The only answer seems to be equities. But the equity market renaissance has been seen in Europe and Japan as well. Despite a weak commodity sector, the TSX is up 5%. While investors have cowered on emerging markets (which are all lower), most major indices have done AOK.

The flip side to any great market rally is that it will inevitably end. The S&P 500 has now gone almost two years without a correction of at least 10%.

The latest breakout has taken U.S. stock averages to new highs. With fiscal policy out of Washington at zero, it has virtually been 100% on the back of the Federal Reserve's Quantitative Easing (QE) programs. But with the economic data beginning to show some strength, the Fed may be about to take the training wheels off as talk of taper timing increases. There is almost a perverse wish against strong economic data because of what the Fed will do.

As much as investors dread the taper, its eventual arrival will be met with some natural consolidation one would think. Just the talk of taper in the spring created the biggest pull back of 2013. Of course, the other side is there are a lot of analysts who want the taper to start because the effect of QE lessened with each tranche, and many question its effect on the economy.

It's hard to imagine after all its efforts these last few years that the Fed will rush into anything that might spook the markets.

So while valuations might no longer be cheap, they are still a long way from peaks seen in previous cycles. The US market trades around 2.5 times book value and for 16.5 times trailing earnings. Looking at the last three major market peaks – 1987, 2000 and 2007 – P/E ratios were respectively 23, 30 and 17.5. The price to book ratio meanwhile peaked at close to 5x in 2000 and 3x in 2007.

Stay tuned,

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